



COMMISSION NEWS

ARIZONA CORPORATION COMMISSION, 1200 W. WASHINGTON, PHOENIX, AZ 85007

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COMMISSION APPROVES ARIZONA'S PARTICIPATION IN MULTI-STATE SETTLEMENT WITH WADDELL & REED

Unsuitable variable annuity exchanges result in penalties and restitution for investors

PHOENIX – With a unanimous vote, the Arizona Corporation Commission approved a settlement with Waddell & Reed, Inc., in connection with its unsuitable variable annuity exchanges. Without admitting or denying the underlying facts, Waddell & Reed agreed to pay \$31,773 in penalties and return more than \$97,000 to 60 Arizona investors who were financially harmed as a result of the transactions. Arizona's portion is part of a multi-state settlement negotiated by securities and insurance regulators that will return \$11 million to investors. There were a total of 81 annuity exchanges involving Arizona investors.

The Arizona settlement divides the total penalty amount equally between the Commission and the Arizona Department of Insurance since both agencies regulate the sale of variable annuities and registration of the individuals who sell them. The Arizona Department of Insurance regulates both the sale of variable annuities and the insurance companies offering and selling them. The Commission oversees the dealer and salesperson who must be registered to offer and sell variable annuities, which are securities.

“This is another example of how we partner with other regulatory agencies for the benefit and protection of investors,” Chairman Hatch-Miller explained. “We are pleased to have a cooperative working relationship with the Department of Insurance in an era when the lines between insurance sales and securities offerings increasingly overlap.”

At issue were Waddell & Reed's instructions to its financial advisers to recommend that customers switch from one variable annuity product to another without providing fair comparisons in terms of features, costs and a net benefit to the customer.

“Under suitability rules, a variable annuity exchange is appropriate only if it provides a net benefit to the customer,” Commissioner Marc Spitzer explained.

“A detailed investigation found that Waddell & Reed benefited from the transactions, not the clients,” Commissioner Bill Mundell said. “The company and its representatives earned a new commission on each exchange and received additional charges. They violated their fiduciary duty by putting their own interests ahead of their clients.”

Investors were harmed in several ways:

- Surrender charges – customers incurred a sales charge for switching annuities. This is a percentage of the amount withdrawn from the annuity, a rate that reduces over the surrender period.
- Mortality and expense charges – some customers paid higher fees to compensate the insurance company for assuming the risk of the new annuity contract, primarily for the death benefit and administrative expenses.
- New surrender period – customers faced additional time – as long as seven to eight years – during which they would be subject to a penalty if they surrendered the new annuity.
- Death benefits – customers were at risk of recovering a lessened death benefit if the stock market performance reduced the value of the new annuity.
- Extra Value Rider – customers received “bonus” credits for making the exchange, but the underlying investments of the new annuity were not expected to provide the returns needed to break even.
- Other riders – customers needed to pay additional fees to maintain their long-term confinement care, disability, nursing home and terminal illness insurance, benefits not included in the new annuity.

“Certain annuities are heavily promoted as ‘safe’ investment alternatives,” Commissioner Mike Gleason said.

“This case demonstrates that there are risks associated with any investment, including the risk that the investment is unsuitable for you. It is critically important to be cautious when making major financial decisions – particularly if someone is encouraging you to surrender one investment in favor of another.”

The Commission found that some of the Waddell & Reed advisers expressed concern that the exchanges were not suitable for all of their customers despite company claims to the contrary.

The National Association of Securities Dealers (NASD) settled its own case in April 2005 with Waddell & Reed agreeing to pay \$5 million in penalties and up to \$11 million in restitution.

“We approved the Arizona settlement in light of the number of commitments Waddell & Reed made with the NASD, Arizona and other states to better supervise variable annuity exchanges,” Commissioner Mayes said. “But I want the company to know that we will be watching closely to protect customers from these types of practices.”

By law, penalties collected by the Commission are deposited into the state’s General Fund.

Caution for Investors

Entrusting your money with someone for investment purposes, while expecting a profit through the efforts of others, may involve a security and sales agents/dealers subject to registration. **VERIFY BEFORE YOU BUY!** Call the Securities Division, (602) 542-4242, toll free (866) VERIFY-9. The Division’s investor education web site also has helpful information at www.azinvestor.gov.

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Editors: Again, the Commission is grateful for the cooperation and assistance of the Arizona Department of Insurance. We encourage you to contact Erin Klug, Public Information Officer for the Department of Insurance at (602) 912-8456 for more information about the agency’s action.